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Monthly Letter on
Economic Conditions
Government Finance

New York, November, 1948

General Business Conditions

THE business news of the past month has been generally favorable, the prevailing spirit of caution notwithstanding. One of the tests of the situation is the state of retail trade, where the effects of any falling off in the ability or willingness of people to buy will show most quickly. Retail reports make it clear that more lines are "catching up", and that many people balk at paying prices they consider out of order. The most dramatic news of the month in merchandising was a cut of 20 per cent in men's clothing prices by a manufacturing-chain store organization, followed by reductions elsewhere. However, the evidence is persuasive that the soft spots are due more to filling up of stocks, and to a natural lessening of the urgency of demand for specific goods, than to loss of buying power.

Where markdowns have been made the response has been excellent. Overall trade figures are good. Department store sales this fall have shown a normal seasonal increase over the summer months and recently have made the widest gains over a year ago in some time. The fact of dominant importance is that people have jobs and money. If they cut down in some directions they are spending in the aggregate more than ever before.

There is also evidence that adjustments in prices or production or both, where required to keep merchandise markets in balance, can be made without pronounced effect on the general situation at this time. One element of strength is the caution of merchandise buyers. According to the latest Federal Reserve figures, as of the end of August, forward commitments of department stores were 13 per cent below a year ago. With sales good and forward buying cautious, stocks must be constantly replenished. Still more important, adjustment in specific lines can be made under the most favorable conditions possible, namely, a state of full employment and a record-breaking income flow, supported by forces which are still strong and promise to continue strong.

The Strength in Durable Goods

In short, various lines are having problems in maintaining sales and employment, but the problem is not general. The problem in steel and automobiles, in the metals industries generally, and in many types of equipment and construction is exactly the opposite, namely, to produce enough to go around. The employment and purchasing power provided by these industries support the markets for the goods in which "catching up" has gone further.

Probably many people do not fully realize the extraordinary levels which durable goods activity in this country has reached. In 1947 the total of business equipment expenditures, plus construction, plus consumers' expenditures on durable goods (as given in the "gross national product" analysis of the Department of Commerce)

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reached $50.5 billion, against only $15.3 billion in 1939. Latest figures available are for the second quarter of 1948, when the annual rate was $57.2 billion. It seems certain that this rate is being maintained, if not exceeded, during the second half-year, and that 1948 as a whole may show an increase of 14 or 15 per cent over 1947.

Over the past two years predictions of an end of this boom have regularly been heard. But capital goods programs have exceeded expectations, unfilled demand for automobiles and some other consumers' durables is about as large as it has ever been, armament orders and more public works are ahead, greater exports of capital goods are wanted, and the situation as a whole is still one of great strength.

Price Movements Mixed

Price movements during the month have been mixed. Farm products have declined further, and despite earlier opinions that it would be a long time before the increase in feed supplies would make meat cheaper, the seasonal drop in livestock prices was earlier and sharper than usual, and both meats and butter have declined at retail. On the other hand, prices of pig iron, aluminum and zinc have risen, and a few increases, not of a general nature, have been made in steel products.

Prices are the center of attention in the business situation. The decline in farm products has been interpreted by many people as a sign that the back of the long inflationary price rise has been broken. It has stopped the advance of the official price indexes and turned the trend sideways or perhaps slightly downward. Nevertheless, the strength of demand for metals and most durable goods, the certainty that the labor unions will ask and perhaps receive fourth-round wage increases, and the prospective rise in armament expenditures suggest that it is too early to write off further inflationary dangers. The answer to this question will be provided not by developments in specific markets — even as important as those for farm products — but by the course of international affairs, by fiscal and monetary policies, and not least by the decisions which people and business take as between spending and saving.

Recent price changes on the whole should be considered as contributing an element of stability to the economic situation. Most prices which have been easing, including both farm products and soft goods, are those which had advanced most. The official wholesale price index lately has been about where it was at the beginning of 1948, but the spread between the prices which had advanced most and those which had risen least has narrowed. This improves the terms of exchange. Lower food prices leave city people with more buying power for other things. At the same time, farmers lose less than others gain because big crops give them more to sell. Forward estimates of farm income suggest a decline, but not of proportions threatening to business in the near future, particularly in view of the farmers' strong financial position.

The lesson that is pointed up by such developments as the weakness in men's wear is the need to set prices that will move goods, which involves increasing productivity, cutting out extravagance, and thereby reducing costs. The greatest possible influence toward recession in production and trade would be a further rise of industrial costs.

It must not be forgotten that in talking about the continuance of business at the present level we are talking about further prolonging a boom of tremendous proportions which has already gone a long time without reaction. The caution of business men has helped keep the situation from getting out of hand; caution by all elements in the economic organization is needed not only to avoid loss, but to land the balloon safely.

Credit Developments

Credit developments during October followed the same general direction as in preceding months. The Federal Reserve Banks continued to add to their vast holdings of long-term Treasury bonds at an accelerated rate — with the object of keeping their prices up and the effect of enlarging the reservoir of lendable funds. The general structure of money rates was unchanged.

The principal result so far visible of the September increases in bank reserve requirements has been the accelerated purchases by the Federal Reserve of long-term Treasury bonds as investors, taking advantage of the peg prices, have shifted out of long-term governments and into securities which involve less risk of market depreciation or offer more satisfactory rates of return. This operation reverses the effort of the Treasury to distribute the debt widely to investors.

During October Federal Reserve purchases of long-term Treasury bonds reached $1.4 billion. This ran official purchases of long-terms (maturing after September, 1953) up to $2.6 billion since September 8 when the reserve requirement increases were announced, to $4.3 billion since the bond price supporting operation was resumed in

June, and to $9.5 billion since November a year ago when fixed pegs were first introduced into the government bond market.

Demand for Credit

The motive force behind the heavy sales of government bonds by investors to the Federal Reserve Banks has been the incessant demand for credit which has continued and grown in direct relationship to the price and income inflation. Available data indicate that the expansion in many forms of credit this year will outstrip 1947. For example, the Securities and Exchange Commission has estimated the net increase in nonfarm mortgage indebtedness of individuals at $1.8 billion during the first half of 1948, compared to $1.7 billion in the corresponding period of 1947. New loans insured by the F.H.A. in the first eight months of 1948 are reported at $2.2 billion compared to $1.8 billion in all of 1947.

Compilations by the Commercial and Financial Chronicle, as shown in the following table, indicate that corporations and State and local governments together raised $6.3 billion new funds through new security issues in the first nine months of 1948 against $4.7 billion in the corresponding period of 1947. A big total for October, indicated by a preliminary tally of major offerings, insures that 1948 will top the $7 billion of funds raised through the new security issues market in 1947. The vast bulk of the new issues are bonds; stock issues account for only about one-ninth of the new issues total.

New Security Issues for Purposes of Raising New Capital
(In Millions of Dollars)

	First Nine Months		
	1948	1947	1946
Corporate			
Railroads	$ 405	$ 153	$ 51
Public utilities	1,914	1,123	283
Industrial & manufacturing	998	956	1,066
Oil	428	165	99
Other corporate	501	360	505
Total corporate	4,246	2,757	2,004
State & municipal	2,055	1,914	704
Total State, municipal, and corporate	$6,301	$4,671	$2,708

The biggest suppliers of new funds to the corporate bond and mortgage market this year have been the life insurance companies. These institutions, which in 1947 cut down their government bond holdings by $1.6 billion to supplement other available funds for lending or investing, this year have considerably speeded up their loan and investment operations, and their sales of government bonds. The following analysis, based on data reported by the Institute of Life Insurance, compares the magnitude of life insurance company lending and investing, and government security selling, in the first eight months of 1948 and 1947.

Changes in Loans and Securities of Life Insurance Companies
(In Millions of Dollars)

	First eight months of	
	1948	1947
Securities of business and industry	+2,568	+1,881
Mortgage loans	+1,581	+ 884
State and local government securities	+ 157	+ 27
Foreign securities*	+ 187	+ 96
Total loans and securities (except U. S. Government securities)	+4,438	+2,888
U. S. Government securities	—1,903	— 732
Total loans and securities	+2,535	+2,156

*Includes bonds of International Bank for Reconstruction and Development.

Bank Lending Slowed

The role of the commercial banks in supplying funds to the capital and mortgage markets has been smaller than that of the insurance companies. While the commercial banks have invested substantial sums in railway equipment trust certificates and shorter term obligations of State and local government bodies, the major part of such investments by banks has represented the reinvestment of the proceeds of currently maturing obligations. As the following table shows, the weekly reporting member banks since the first of the year show a net rise of only $81 million under the heading of "other securities" — which is made up mainly of corporate and municipal securities.

Changes in Loans* and Investments of Weekly Reporting Member Banks
(In Millions of Dollars)

	Jan. 1 to Oct. 20, 1948	Jan. 1 to Oct. 22, 1947
Business loans	+ 584	+2,249
Security loans	— 368	— 913
Real estate loans	+ 524	+ 805
Loans to banks	+ 118	+ 82
Other loans	+ 353	+ 508
"Other securities" (except U. S. Gvt.)	+ 81	+ 265
Total loans and investments (except U. S. Government securities)	+1,292	+2,996
U. S. Government securities	—3,811	—2,421
Total loans and investments	—2,519	+ 575

*The breakdown of loans for October 20, 1948, reported on a gross basis, has been adjusted to an estimated net basis for consistency with the other figures.

The item, "Real estate loans", at the same time reveals a diminished, though still considerable, participation of the member commercial banks in financing housing construction. The increase from the first of the year up to October 20 amounted to $524 million. In the corresponding period of 1947 the increase was $805 million.

Commercial, industrial, and agricultural loans — the biggest loan category — also show a smaller rise this year than last, $584 million compared to $2,249 million. "Other loans", which include

instalment loans to individuals, again are up less than in 1947. In total, loans on the books of the weekly reporting member banks, plus investments other than in U. S. Government obligations, show a rise of $1.3 billion since the first of January against an increase for the corresponding period of 1947 of $3 billion.

The $3.8 billion drop in government securities held by the reporting banks is the result of the combination of several factors. The large Treasury cash surplus earlier in the year, which was applied mainly to the retirement of Federal Reserve-held debt, put the banks under pressure to sell government securities to meet losses of deposits and reserves. Further sales were made to raise cash to meet the ordered increases in legal reserve requirements. Other government securities were sold by banks shifting into other types of earning assets.

Contradictions of Policy

The foregoing is a good illustration of the difficulty, if not impossibility, of putting effective restraints on credit by a piecemeal and contradictory approach. Beginning last winter pressure was put on banks and they adopted a voluntary program of screening their loans carefully. The figures bear out that the banks have done this. At the same time the Federal Reserve Banks have been buying up vast quantities of marketable government bonds from nonbank investors, putting them in funds to lend, invest, or spend. In this "nonbank" area no effective restraint is maintained. Rather the authorities have offered a standing "commitment" to buy up all the long-term Treasury 2¼s and 2½s that may be offered to them at fixed prices of par or better.

The inflationary consequences of the bond-pegging operation have been stated on a number of occasions by officials of the Federal Reserve System. Their dilemma has been, as Governor Szymczak put it in a speech at Minneapolis October 11,

> to seriously modify the policy of supporting the Government securities market in the interest of credit control, and thereby risk demoralization of our capital markets; or to adhere to the support policy and risk the possibility of a further serious inflation resulting from excessive expansion of bank credit.

Either horn of the dilemma, he felt, would obviously be intolerable. "Would escape between them be possible?" It may be necessary, he suggests, to devise additional instruments of credit control over bank reserves as an alternative to "new techniques of control much less compatible with the framework of our free enterprise economy."

What these alternative "new techniques of control" might be Governor Szymczak did not say. Overseas one of the means of keeping up quoted prices of government securities has been to forbid people to sell them. There is a question whether any "techniques" which would not have this practical effect would work. And experience this year gives no encouragement to the idea that new techniques applied solely to the commercial banks, or to the member banks, can be fully effective so long as Federal Reserve credit is made so freely available to nonbank investors.

The Biggest Question

The biggest question of all is whether rigidly pegged markets for government bonds can be held compatible with free enterprise and a stable price level. The principle was stated in the summary report of the Committee on Public Debt Policy:

> Interest rates have two great functions which they cannot fulfill without some flexibility of movement.
>
> One of these functions is the adjustment of the supply of savings to the amount required for a dynamic economy under capitalism . . . In the long run the price of money – the interest rate – is one of the factors to insure a flow of needed savings.
>
> The second and more immediate function of the interest rate is as one of the controllers of the flow of credit. In the old days booms were checked when the money ran out, and the signal was a rise in money rates. Today this mechanism is dominated by the central bank and the treasury in each country. But even central banks and treasuries cannot have their cake and eat it too; they cannot exercise controls over excessive credit expansion and at the same time keep money excessively cheap for government borrowing. When a Federal Reserve bank buys government bonds to peg the price, Federal Reserve money flows out and increases the money supply. This is wholly inconsistent with the effort to fight inflation by reducing the money supply in other ways. Also the pegging of the price prevents an upward move in money rates which in itself has a restraining influence on the security markets, new financing, and borrowing from banks.
>
> If we are to avoid great swings of the business cycle that do so much damage, we cannot afford to be left without the response which money rates naturally make to the over-extension of credit.

Third Quarter Earnings

Industrial corporation reports covering the third quarter that have been issued during the past month show in a majority of cases new high totals in sales billed and in net income. This unusually favorable showing is the result of another quarter of near-record manufacturing operations. Except for vacation shutdowns and minor instances of curtailment, the industries have been working at virtually full capacity, and both capacity and efficiency have been increased

NET INCOME OF LEADING CORPORATIONS FOR THE FIRST NINE MONTHS

Net Income is Shown as Reported—After Depreciation, Interest, Taxes, and Other Charges and Reserves, but Before Dividends. Annual Rate of Return for Nine Months is Computed on Net Worth, Which Includes Book Value of Outstanding Preferred and Common Stock and Surplus Account at Beginning of Each Year.

(In Thousands of Dollars)

		Net Income by Quarters					Net Income Nine Months		% Annual Return Nine Months	
No. of Cos.	Industrial Groups	3 Qr. 1947	4 Qr. 1947	1 Qr. 1948	2 Qr. 1948	3 Qr. 1948	1947	1948	1947	1948
24	Food products	$ 36,254	$ 41,030	$ 35,619	$ 35,838	$ 35,543	$115,968	$107,000	20.1	16.8
27	Textiles and apparel	22,159	26,360	26,547	27,038	24,185	65,917	77,770	21.7	22.5
16	Pulp and paper products	19,872	19,982	22,293	22,115	20,946	62,261	65,354	26.9	28.0
38	Chemicals, drugs, etc.	86,704	96,566	102,043	103,486	115,184	277,202	320,713	17.0	16.9
16	Petroleum products	152,190	202,975	227,637	246,339	244,478	410,825	718,454	14.1	21.3
15	Cement, glass, and stone	16,806	18,758	18,582	24,463	26,498	51,821	69,543	18.3	20.8
30	Iron and steel	86,371	95,641	108,865	104,283	133,561	289,539	346,709	11.1	12.6
14	Electrical equip. and radio	42,880	71,508	50,965	53,556	49,697	129,871	154,218	18.4	19.5
28	Machinery	12,388	15,744	14,407	11,278	17,162	38,813	42,842	16.0	16.2
8	Office equipment	14,664	20,628	15,658	20,085	18,094	46,671	53,837	25.3	25.4
12	Autos and trucks	82,570	86,783	107,947	119,256	129,367	238,236	356,570	19.3	26.1
20	Automobile parts	14,782	15,140	17,516	15,413	19,058	46,329	51,987	20.5	20.1
64	Other metal products	46,088	42,713	47,039	47,841	54,524	131,135	149,404	16.9	17.4
31	Miscellaneous mfg.	27,333	39,776	28,243	31,170	35,870	88,634	95,283	17.7	17.0
343	Total manufacturing	661,056	793,599	823,361	862,156	924,167	1,993,222	2,609,684	16.1	18.7
26	Mining and quarrying	31,978*	38,844*	38,508*	42,514*	43,772*	86,988*	124,794*	17.0	21.7
17	Trade (retail and whol.)	11,008	14,682	9,005	10,833	12,092	28,887	31,930	13.5	13.7
14	Service industries	4,603	5,252	2,995	5,773	4,895	12,749	13,663	11.2	11.7
400	Total	$708,645	$852,377	$873,869	$921,276	$984,926	$2,121,846	$2,780,071	16.0	18.7

*Before depletion charges in some cases.

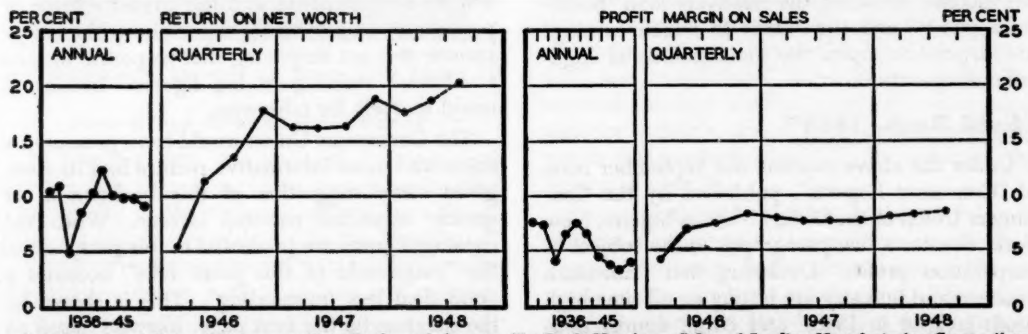
this year by bringing newly-constructed and modernized plants into production.

Manufacturing corporations reporting sales figures show for nine months this year a combined increase of approximately 22 per cent over the first nine months of 1947. Part of this increase was in physical volume, and part resulted from advances in wholesale prices. According to the official indexes, prices of semi-finished manufactures are up on an average about 4 per cent over a year ago, and finished manufactures are up 6 per cent.

Our tabulation of the reports of 400 companies issued to date, which are representative for the most part of the larger manufacturing enterprises but include also a limited number in the mining, trade, and service industries, shows for the third quarter of this year a combined net income after taxes of approximately $985 million, which compares with $921 million in the second quarter this year, and $709 million in the third quarter of 1947.

For the first nine months of this year the combined net income of these companies totaled $2,780 million, compared with $2,122 million in the same period of 1947, an increase of 31 per cent. There were particularly substantial increases in sales and earnings in such groups as refined petroleum products, chemicals, textiles, building materials, iron and steel, automobiles and parts, electrical and radio equipment, and various other metal products – heating and plumbing fixtures, office equipment, and household appliances.

The reporting companies had at the beginning of this year an aggregate net worth, made up of capital stock and surplus accounts taken at book value, of $19.8 billion, upon which the nine



Average Annual Rate of Return on Net Worth, and Average Net Profit Margin on Sales, of Leading Manufacturing Corporations. (Quarterly figures for 1946-47 based upon 400 manufacturing corporations, with third quarter of 1948 partly estimated. Annual figures for 1936-45 based upon our tabulations of annual reports covering a much larger number of manufacturing corporations.)

months' net income represented an annual rate of return of 18.7 per cent, compared with a net worth of $17.7 billion last year and a return of 16.0 per cent. The net worth is based upon balance sheet values of assets, including plant and equipment carried at original costs going back many years, less accrued depreciation, and therefore the rate of return would be much lower if based upon present-day replacement costs.

The foregoing summary shows, by major industrial groups, the earnings for the past five quarters, and for the first nine months of 1947-48, together with rate of return on book net worth.

The longer-term trends in earnings of large manufacturing corporations, measured by average profit margin on sales and return on net worth, are shown by the charts at the bottom of the page, with the third quarter 1948 figures partly estimated.

In measuring earnings by these combined totals, the large increases that continue to be made by some companies act to offset and thus obscure the decreases being experienced by an important minority of others. The latter include many of the largest and most prominent organizations in their respective industries, which were affected adversely by such factors as supply catching up with demand, production costs rising faster than selling prices, stiffening consumer resistance to higher prices, intensified competition, selling expenses increasing to move accumulating inventories, or, in some instances, prolonged strikes.

For example, despite the sharp gains shown in the dollar totals for the third quarter of 1948, 31 per cent of the reporting companies had lower earnings than in the third quarter of 1947, and 48 per cent or nearly one-half had lower earnings than in the second quarter of 1948. In the growing number of cases where volume of sales actually declined, there were much sharper drops in net income, revealing the relatively high "break-even points" and the extent to which earnings are dependent upon the maintenance of high-volume operations.

"Gold Rush, 1948"

Under the above caption, the September issue of "Consumer Reports", published by the Consumers Union of the U. S., 17 Union Square, New York, devotes a few paragraphs to the subject of corporation profits. Declaring that "American business and industry are hitting an all-time high profit jackpot in 1948," and citing figures published by this Bank showing earnings of 525 leading industrial corporations for the first half of this year running 28 per cent over the same period of last year, or an annual rate of return on net worth of 18.8 per cent against 16.3 last year, the article goes on to say:

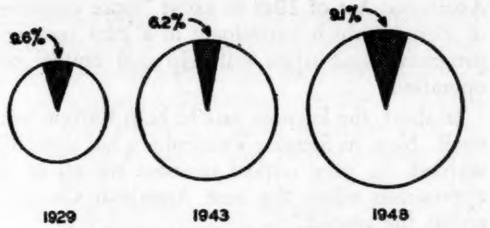
> With the first half figures in, CU's economic consultants have made an estimate of corporate profits for the whole of 1948, based on available Commerce Department data. Their projection indicates that corporate profits *before taxes* in 1948 will be around 33 billion dollars compared with about 29 billion in 1947. They estimate corporate profits *after taxes* this year at around 20 billion dollars compared with last year's record-breaking 17.5 billions.
>
> The magnitude of this profit take is all the more astounding if it is compared with the wartime peak of 24 billion dollars in profits before taxes and 14 billions in profits after taxes in 1943. Back in 1929 profits before taxes were 9 billion dollars and profits after taxes 8 billions.
>
> CU's economic consultants point out that corporate profits after taxes have increased more than 100 per cent and profits before taxes about 50 per cent since 1946. By contrast, inflation reduced the purchasing power of the average consumer by 10 per cent in the same period, 1946 to 1948.

The foregoing is typical of statements constantly pouring out over the radio and in the press and other publications headlining "record-breaking" profits and stressing large gains, both in actual dollars and percentagewise, over prewar or other selected years in the past. The effect, unintentional in many instances, is to give the impression of corporate earnings swollen out of all proportion to other elements of the national income. Actually, what are the facts?

Corporate vs. National Income

No one, of course, disputes that profits in general have risen spectacularly and are larger than ever before. This is a matter of record. But what statements like the above fail to bring out is the tremendous increase in other segments of the national income as well. With the national income total expanded to approximately triple prewar by inflated prices and the largest volume of peacetime employment the country has ever known, it is not surprising that corporate income is likewise running to big figures. Indeed, it could scarcely be otherwise.

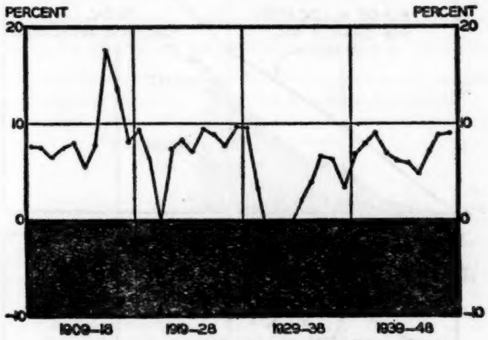
The Consumers Union would have presented a fairer and more informative picture had its story given some suggestion of this background of greatly expanded national income. When the earnings figures are presented in this perspective, the "magnitude of this profit take" becomes a good deal less "astounding". This is shown by the diagram on the next page, likewise based on Commerce Department data, covering the three years mentioned in the quotation.



Percentage of Corporate Net Income After Taxes to Total National Income

It will be seen that corporate earnings in 1948 have in truth increased largely over both 1929 and 1943. But when the figures are considered in relation to the continuing increase in total national income, the proportionate share of earnings is actually slightly lower than in 1929, though higher than in the war year 1943. In that year, corporations were operating to a large extent on government orders and earnings were held down by controls over selling prices, voluntary price reductions, renegotiation of contracts, and high excess profits taxes.

In other words, the corporate share of the national income "pie" has not increased, except as compared with the war period, but the size of the total "pie" to be divided up has increased enormously. The accompanying long-term diagram comparing the ratio of corporate profits to national income by years back to 1909 might well be labelled – Puzzle: Find the "Gold Rush, 1948."



Percentage of Corporate Net Income After Taxes to Total National Income.

How Other Groups Have Fared

In contrast with this showing for corporate income, it is interesting to see how other leading components of the national income have fared. This appears in the table giving the Department of Commerce breakdown of national income by distributive shares, both in dollars and percentages, for the three years in question.

Here we see that compensation of employes, farm income, and business and professional income of individual proprietorships, partnerships, and other unincorporated enterprises (mostly small business) have been the heaviest gainers dollarwise, approximately trebling in each case between 1929 and '48. At the same time all three of these groups also increased their proportionate shares of the income "pie". In the case of compensation of employes, the ratio is down in '48 compared with '43 when income payments under this heading were abnormally swelled by armed service payrolls and the wartime expansion of the civilian labor force.

National Income by Distributive Shares

Dollar Totals in Billions	1929	1943	1948*
Total national income	$87.4	$168.3	$218.3
Compensation of employees	50.8	109.1	133.8
Business and professional income	8.3	14.1	25.2
Farm income	5.7	11.8	18.5
Rental income of persons	5.8	6.2	7.6
Corporate profits before tax	9.8	24.5	32.4
Corporate tax liability	1.4	14.2	12.6
Corporate profits after tax	8.4	10.4	19.8
Dividends	5.8	4.5	7.3
Inventory valuation adjustment	.5	— .8	— 3.9
Net interest	6.5	3.4	4.7
Percentage Distribution of Totals			
Total national income	100.0	100.0	100.0
Compensation of employees	58.1	64.8	61.3
Business and professional income	9.5	8.4	11.5
Farm income	6.5	7.0	8.5
Rental income of persons	6.6	3.7	3.5
Corporate profits before tax	11.2	14.6	14.8
Corporate tax liability	1.6	8.4	5.8
Corporate profits after tax	9.6	6.2	9.1
Dividends	6.6	2.7	3.3
Inventory valuation adjustment	.6	— .5	— 1.8
Net interest	7.4	2.0	2.2

*Annual rate, seasonally adjusted, for first six months.

Rise in rental income was retarded by rent control, while interest income actually declined as interest rates were forced down by cheap money policies. Both landlords and bondholders have found their proportionate shares of the national income substantially reduced. The share of dividend payments in the national income was cut from 6.6 per cent in '29 to 3.3 in '48, or by one-half.

The question is who benefits from high corporate earnings. Most of them have not gone into the pockets of shareholders, for the proportion of earnings distributed as dividends has declined from 69 per cent in 1929 to 43 per cent in 1943, and an estimated 38 per cent in 1948. The retained earnings are the means of buying more tools for industry, and so making possible higher wages and meeting more fully the needs of the American people.

Certainly there is nothing in this showing to warrant pointing an accusing finger especially at corporate earnings in the general rise of the national income that has taken place. This statement, it should be noted, applies to the overall total of corporate earnings, and not necessarily to individual companies, some of which show

earnings increases much greater than the average. However, overall profits are what the Consumers Union is talking about, and it is in these terms that most of the controversy over whether profits are "too high" or not is carried on.

The fact that total wages and salaries (including unincorporated business and government) exceed corporate net income this year in the ratio of over 6 to 1, and exceed corporate dividends by over 18 to 1, indicates the relative importance of these factors in general prices and cost of living.

As for the observation in the last paragraph of the quotation that, while corporate profits increased sharply, "by contrast, inflation reduced the purchasing power of the average consumer", the fallacy of such comparison need hardly be pointed out. What does the Consumers Union think has happened to the purchasing power of the corporate dollar, or of the dividend and interest dollars of the millions of men and women who have invested their money in American corporate enterprises?

Progress of the ECA

The Economic Cooperation Administration, charged with the overall direction of the European Recovery Program, is now well into the third quarter of its first year of activity. Of the $5,055,000,000 provided by the Congress for the first fifteen months of the program, April 3, 1948 to June 30, 1949 — with the proviso that, with Presidential approval, the entire sum might be spent in twelve months — it is now anticipated that all but about $700,000,000 will have been allocated by January 1 next. Thus, one of the first tasks of the new Congress will be to consider the question of additional appropriations for the second ERP year beginning next April. Already, ECA officials have indicated their intention to ask the Congress for a deficiency appropriation to carry the program through the final quarter of the fiscal year ending next June.

One of the guiding factors for the Congress and the American people, in arriving at sound decisions, will be the extent of progress towards attaining the objectives of this gigantic and unprecedented enterprise. These objectives were clearly set forth in mutual undertakings. The participating European countries pledged themselves, in the Convention for European Economic Cooperation, to "undertake the elaboration and execution of a joint recovery program" in order "to achieve as soon as possible and maintain a satisfactory level of economic activity without extraordinary outside assistance." On its part, the United States undertook in the Foreign Assistance Act of 1948 to assist "those countries of Europe which participate in a joint recovery program based upon self-help and mutual cooperation."

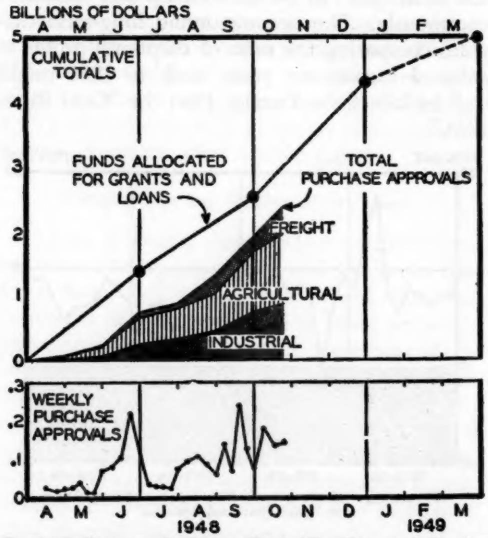
In short, the keynote was to help Europe help itself. Now, as Senator Vandenberg has solemnly warned, "A very critical moment for all of us approaches when the next American Congress audits the record."

What, then, does the record show?

Grant and Loan Operations

In the first place, we have to consider the amounts and kinds of aid that Europe has actually received. Of the $5.1 billions already mentioned, $4.1 billions was set up for grant aid, and $1 billion for guaranties and loans — the latter to be obtained by selling notes to the U. S. Treasury through the Export-Import Bank.

The accompanying diagram shows the schedule of tentative allotments by the ECA to the end of December, amounting to $4.3 billions for both grants and loans, together with the trend of actual orders (procurement authorizations) from the inception of the program in April through October 20.



European Recovery Program; Fund Allocations and Purchase Approvals (procurement authorizations)

As will be seen, placement of orders was slow in starting and, except for a temporary bulge in June, lagged considerably behind allotments up to last August. Since then, placement of orders has picked up, and the spending of funds set aside for grants is now practically on schedule.

Not so in the case of the funds earmarked for loans. Except for a small loan to Iceland, no credit was consummated until late October, al-

though the rule is that (with a few exceptions) the participating countries must borrow in order to receive the full grant aid. Now, however, this log jam appears to be broken. On Oct. 25 a $310 million loan to Great Britain, at 2½ per cent, repayment not to begin until 1956 nor to be completed before about 1983, and with an "escape" clause, was announced. Nine other countries are expected to take up an additional $515 million in loan funds in the near future.

Likewise, prospects for use of the ECA $300 million investment guarantee fund are slowly beginning to open up. In order to stimulate new private American investment in European reconstruction projects, the ECA is empowered to guarantee the conversion into dollars of earnings from approved new investments or of proceeds from the liquidation of such enterprises. The guarantee is limited to the amount invested, which means that the investor is not assured of getting *both* the investment and its earnings back in dollars; and this provision evidently is a drawback to its use. However, within the past month details of the first project to be undertaken have been announced, involving construction of a plant in Britain, and other projects are under negotiation.

All this indicates that the ECA is swinging into its stride. This is shown also by the steadily increasing proportion of industrial raw materials and capital goods in the procurements. While shipments of food and agricultural products are likely to continue large for some time, the encouraging thing is the rapid growth in the flow of industrial commodities that go to help these countries rebuild their own production and stand on their own feet.

European Recovery Program: Purchase Approvals, Apr. 3-Oct. 20, 1948. By Selected Commodity Groups and Areas of Origin

(In Millions of Dollars)

	All Countries	United States	Canada	Latin America	Western Europe	Other Countries
Bread grains	501	337	164	—	—	—
Meats and dairy products	116	45	57	10	4	—
Fats and oils	104	42	7	5	22	28
Coarse grains, feeds, etc.	89	68	6	9	3	3
Tobacco	42	38	—	—	2	2
Fruits and vegetables	32	16	—	1	15	—
Sugar and miscellaneous	43	12	—	28	1	2
Foods and tobacco	927	558	234	53	47	35
Petroleum and products	238	87	—	49	31	71
Coal and related fuels	146	86	—	—	58	2
Nonfer. metals, ores, etc.	145	37	64	34	10	—
Cotton	132	132	—	—	—	—
Lumber, sawmill products	46	14	32	—	—	—
Primary iron & steel prod.	42	28	—	—	12	2
Fertilizer	22	2	1	5	13	1
Hides, skins and leather	21	9	1	9	1	1
Indust. raw materials	792	395	98	97	125	77
Vehicles, railway equip.	64	37	—	—	24	3
Machinery, plant equip.	59	52	1	—	6	—
Chemicals and medicinals	46	40	—	4	1	1
Textiles, basic	23	5	—	3	—	15
Pulp and paper	22	1	9	—	11	1
Advanced iron & steel prod.	13	10	1	—	2	—
Others	30	25	2	—	3	—
Industrial products	257	170	13	7	47	20
Grand Total	1,976	1,123	345	157	210	132
Percent distribution	100	57	17	8	11	7

The foregoing table gives the cumulative breakdown of purchase approvals by commodities and areas of origin for the period from April 3 to Oct. 20, 1948.

Impact on U. S. Economy

Largely because of the time required before ECA operations rise to their full tide, it is too early to assess the impact of the program upon the U. S. economy. To the extent that procurements have centered on agricultural products, they have dealt with goods that were, or gave promise soon to be, in ample supply; hence the effect has been to cushion falling markets rather than drive prices higher.

On the other hand, orders for commodities such as steel, nonferrous metals, oil, forest products, and various types of machinery have fallen upon markets in tight supply and thus tended to increase inflationary pressures. The fact that the flow of many of these commodities was slow in starting has, of course, minimized effects thus far. The real test in this area is only beginning.

One of the most important factors tending to soften pressures here has been the high proportion of requirements filled outside this country. As shown by the table, orders placed during the period covered aggregated nearly $2,000 million (excluding technical services and ocean freight). Of this amount, over $1,100 million, or 57 per cent, was placed in the United States, nearly half of which represented commodities classified as "surplus". By contrast, offshore purchases amounted to 43 per cent, or about $850 million, over half of which were for "bottleneck" commodities.

The OEEC

In order to start the ball rolling last Spring, the ECA made temporary allotments to the various countries. At the same time, however, a permanent body of the recipient countries, the Organization for European Economic Cooperation (OEEC) was created, with headquarters in Paris, to develop and carry through, with the assistance of the United States, the combined program for rehabilitation.

Through OEEC, a high degree of responsibility for the initiation of programs, decision on allocations, and mutual policing is placed squarely on the participating nations. The ECA exercises overall supervision and control, determines

whether the assistance requested is feasible and in accord with the Act, and puts up the money.

In furtherance of this program, the OEEC was given two big assignments last summer:

(1) To apportion the ERP aid among the participating countries for the 12-month period ending June 30, 1949.

(2) To determine the amount of mutual aid in order to reduce the total dependence of the 19 participating countries on the United States.

As to (1), each country was asked to draw up a full year's balance sheet of its import requirements and its exportable surplus. Only that part of the requirements that could not be satisfied from within western Europe was to be supplied through ERP aid.

All this was a time-consuming affair, but agreement was finally reached – though not without prodding from the ECA. The full year "shopping programs" are now being reviewed by Washington for making adjustments to the availability of goods here. With the completion of these steps, the cumbersome screening which the average European importer's order has to pass through should be simplified. Moreover, with advance allocations and purchase approvals, participating countries will know ahead what they can count on. All this and the spending of loan funds should boost the placing of orders for tools, machinery, and capital goods in general.

Unfreezing Intra-European Trade

As to (2) above, a system of intra-European assistance has been set up designed to encourage trade among the participating countries.

Although by the end of 1947 nearly all the ERP countries (Germany and Greece excepted) had reached or exceeded their prewar output, their mutual exchange of goods has stagnated around half the prewar volume. The reasons have been many: unwillingness to hold their neighbors' inconvertible currency, high prices, and the varying stages of postwar economic recovery. Norway had to limit her purchases of steel from Belgium last summer because the latter had only limited use for kroner. Italy declined to sell her fruit surpluses for guilders and marks. Worse, the inability to trade with each other inflated European countries' estimated needs from the United States.

The mutual aid plan, reduced to its simplest basis, works as follows: The ECA will use a part of ERP aid to make so-called "conditional grants" of dollars, on condition that the creditor countries – such as Great Britain and Belgium – will make equal grants of their own currencies to debtor countries such as France or Austria.

The table below shows the distribution of direct dollar aid and intra-European contributions, as agreed upon by the OEEC in Paris in September. France will be the largest beneficiary. Britain's net contribution is $282 million, which amount it will receive in dollars as a "conditional allotment". In addition, Great Britain agreed to export to other ERP countries goods worth $216 million to be paid for by drawing on their sterling balances.

The First E.R.P. Year: Preliminary Schedule of Direct Dollar Aid, European Contributions and Loans
(In Millions of Dollars)

	Total Dollar Aid	Intra-European Contribu.*	Net Aid
United Kingdom	1,263	—282	981
France	989	+323	1,312
Italy	601	— 20	581
Netherlands	496	+ 72	568
Germany—U.S. & British Zones	414	— 10	404
Belgium—Luxembourg	250	—208	42
Austria	217	+ 64	281
Greece	146	+ 67	213
Denmark	110	+ 7	117
Germany—French Zone	100	+ 1	101
Norway	84	+ 32	116
Eire	79	—	79
Turkey	50	— 20	30
Sweden	47	— 25	22
Trieste	18	—	18
Iceland	11	—	11
Switzerland	—	—	—
Portugal	—	—	—
Total	4,875		4,875

*Net outgo (—); net income (+).

The preparation of these schedules has represented a monumental job, involving not only difficult economic problems but also cutting across many political barriers raised by competitive and nationalistic traditions. That it has been possible to do it at all is encouraging evidence of the effectiveness of the organization that has been set up and of the determination of the European countries to make it work.

The Objectives and the Record

From the foregoing it is apparent that ERP is emerging from the initial stage. Much good work has been done. ECA's operational and organizational problems have been largely overcome and decisions reached on major policies.

What Congress and the American people will now ask is whether the effort is producing results. The record cannot be confined to reports of organizational progress and to statistics of allocation and procurement. The fundamental question is what the aid is accomplishing toward realizing the objectives of the program.

The most immediate of the objectives was to relieve suffering, to relax the economic pressures making for political disunity, to supplant despair by hope, and so to strengthen the moderate and democratic forces of Western Europe in their stand against communism. In considerable measure the program has already brought results. It

was a factor in stopping the communists in Italy, and in other participating countries the danger of the communists gaining power through internal coups is today much less. The disruptive influence of communist minorities remains, and the daily news from France shows their power to foment disorder. But in general the communist shadow is now an external rather than an internal danger.

Another objective of the joint program, one which in fact is the summation of all the objectives, is to enlarge European production. In this area progress in most cases is gratifying. The larger crops harvested this year have helped the ERP countries along the road to self support, and industrial production also has continued to improve, if slowly. Dollar deficits in balances of payments are becoming smaller. During the past month Mr. Hoffman, who went to Europe to see for himself, was able to say that ERP aid next year could be in a smaller amount than this year.

A third objective of the program is to bring about greater unity of action and a greater use of common resources in Western Europe. Of the steps taken toward that end, the OEEC is the outstanding example. It has made an auspicious beginning in the face of great difficulties. But any comparison between the accomplishment to date and the highly coordinated and unified effort needed for self-defence and self-support will show that there is still a long way to go.

A fourth objective is to conquer inflation, bring about fiscal and monetary reforms, reestablish confidence in currencies and make a firm start toward exchange stabilization. Again some progress has been made in some countries. Others, which made commitments as partners in this joint effort, have a long way to go to fulfill them. This country can sympathize with the difficulties, but it cannot have confidence that ERP will yield lasting benefits, or that the problem of dollar shortage can be solved, in countries which are unable to check inflation and get their government finances and monetary systems in order.

The Need for Understanding

For one country to give, and for another to receive, economic aid on the scale contemplated by ERP is difficult for both. It is difficult to help people without taking away some of their sense of responsibility for their own situation; and it is difficult to insist that they make and live up to rigid commitments without provoking bad feeling. The recipients think that their power to decide and act for themselves is infringed, while the giver fears that the program will be ineffective and the effort wasted if things go on as they are in certain respects in recipient countries. To overcome these basic difficulties and minimize bad feeling requires great wisdom.

The safeguards by which the United States hopes to keep ERP effective, to prevent waste and to restrain inflationary effects here as far as possible, may now be considered well-established. One is that allocations and grants are made for only a year at a time, and that new appropriations presuppose successful use of the old. Another is that the amount of aid should diminish from year to year. If the program makes the progress intended, this follows naturally. If it does not make progress, American opinion cannot be expected to support it indefinitely.

Another cornerstone of American policy is that the "counterpart deposits" of foreign currencies, representing the local proceeds of the sale of goods received from this country, shall be used only by agreement with us. We on our part must use this power to lay down terms and conditions carefully and considerately. Again, American policy is to put a great weight of responsibility on the Europeans through the OEEC; the European obligation is to carry on the job efficiently and cooperatively. Bickering over the division of aid, inflation of requests, inability to work together in the general interest, all play into the hands of cynics here.

In this country it must be realized that there are limits to how far we can go in telling other countries just what policies they must follow. We must not over-estimate the advantages nor under-estimate the difficulties connected with ambitious schemes for various types of economic cooperation or even union. Another thing to guard against is pressure at home to turn ECA into an agency for price support and surplus disposal, instead of providing Europe with what it really needs.

There is great need for understanding of these matters on both sides of the Atlantic. Even with the progress to date it is doubtful that smooth sailing is ahead for ERP. Political uncertainty is aggravating many unsolved problems. Trade between Eastern and Western Europe, which is one of the requisites to lessening dependence upon American resources, is not picking up materially. Currency convertibility is a touchy subject and inflation is threatening to wipe out gains made in France, one of the key countries. But no one has expected this gigantic and unprecedented enterprise to be easy. It will work only with the most continuous effort, the greatest possible wisdom and diplomacy, and the utmost in collaboration that can be achieved.

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